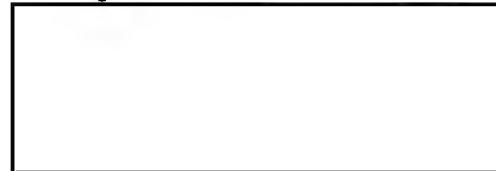


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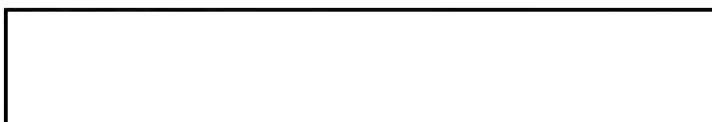
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MALTA: Prime Minister Mintoff's reversion to a tough bargaining stance, while aimed at bringing pressure on the UK and its NATO allies, leaves open the possibility that he will resort to alternative financial arrangements.

The UK High Commission in Valletta claims that Mintoff's reply to the British negotiating proposal of 1 September has brought the talks "to the breaking point." Blaming London for the present state of affairs, Mintoff has demanded that a message reach Valletta today indicating that Prime Minister Heath will come to Malta with a more generous negotiating proposal. Mintoff's response is not surprising because the British proposal essentially repeats an earlier offer known to be unacceptable to Valletta.

Three of the UK's NATO partners--the US, Italy, and West Germany--now have agreed to increase their pledges to the UK-NATO offer, bringing the total package to \$22.2 million. In addition, Belgium has indicated that it is "considering the problem positively." The British hold that their share is already "very large" and the UK-NATO offer "generous." The US Embassy in London believes the British are unlikely to increase their contribution, and they have indicated that Heath will not go to Malta. Even before Mintoff's emotional reply, the British [Redacted] were taking a rigid approach to the Maltese demands.

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In an address on Saturday inaugurating week-long festivities centering on National Day on 8 September, Mintoff made a thinly veiled reference to better relations with Libya. He still appeared to leave room, however, for a new agreement with the UK. Mintoff has already signed a short-term aid agreement with Tripoli, but he has hesitated to commit himself further because he is concerned over what Libya may demand as a quid pro quo.

(continued)

Mintoff is expected to make another address during the National Day celebrations. He could use that occasion, unless an acceptable negotiating proposal has reached Valletta, to announce a decision accepting Libyan or even Soviet financial assistance. The Russians reportedly have offered an annual cash payment for three years, which Mintoff might find acceptable, although he is likely to reject any deal involving a Soviet military presence on the island.

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INDIA: New Delhi is exploring the possibilities of new regional ties along the lines of its recently concluded treaty with the USSR.

The Indians are anxious to show that they remain essentially nonaligned and are not solely tied to the USSR and its allies. Moreover, they were badly shaken by recent Sino-US diplomatic developments and probably feel the need to strengthen their position with their Asian neighbors. New Delhi probably believes that it would have Soviet support for these overtures.

The Indians have already approached the Japanese about a treaty and may also be making similar proposals to other countries in the area. [Redacted]

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[Redacted]

The Japanese were cool to the Indian approach. They are leery of Soviet involvement and are concerned about their relationship to existing regional organizations. The Nepalese are also likely to be unenthusiastic because of their special problems with China. [Redacted]

In the past, the Ceylonese have led New Delhi to think that, although they would not sign a treaty with the USSR, they might sign one with "someone else." Recently, however, the Ceylonese have become fearful that the Soviets may be able to increase their influence in the Indian Ocean via their treaty relationship with India. Colombo has therefore revived a long-standing proposal and has embarked on a diplomatic offensive to turn the area into a "Peace Zone," free of offensive and defensive weapons. As a result, the Ceylonese are likely to be preoccupied with their own diplomatic efforts. [Redacted]

CAMBODIA: Political tensions in Phnom Penh have eased.

The National Assembly has agreed to postpone its interpellation of Finance Minister Sok Chhong--which would have been tantamount to a vote of no confidence--and has signaled its readiness to consider major economic reforms that the government will propose, perhaps later this week. Chief of State Cheng Heng has told the US ambassador in Phnom Penh that Chhong, in turn, has agreed to stay on in the cabinet and to see the economic program through the legislature.

Chhong, one of Cambodia's few trained and competent economists, had been under pressure to resign by a small but vocal assembly minority because he was the architect of some earlier, unpopular government economic policies. Lon Nol and Sirik Matak have been anxious to avoid any showdown with the assembly as other ministers were said to be ready to quit in sympathy with Chhong. Such a development could have brought down the government, worsening the turbulent political scene already agitated by the personal animosities and ambitions of a number of government leaders.

The formulation and implementation of one of the key new economic programs--the Exchange Support Fund (ESF), a multinational aid arrangement--is expected to take some time and the assembly's acquiescence in the matter means in effect that Chhong's interpellation will be suspended indefinitely. It also suggests that the assembly is ready to cooperate with the government in facing up to Cambodia's knotty economic problems, apparently a recognition that the threat of continued political instability in Phnom Penh could have jeopardized the ESF as well as the prospects of a cash grant to the Cambodians now under study in Washington.

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